Rising costs throw Chinese manufacturing into crisis

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For years, China's cheap labour has helped global corporations push down the wages and conditions of workers around the world. Cheap goods churned out by sweatshops based in China also kept inflation low internationally and underpinned the low interest rate policy in the US that fuelled its financial and housing bubbles.

All this is coming to an end. Thousands of manufacturers have shut down or moved out of China because of rising raw materials costs, higher wages and the rise of the yuan against the US dollar. These processes are in turn accelerating inflationary pressures, not just within China, but internationally.

Small and medium firms (with capital under $US3 million) in China's light industries, such as shoes and textiles, have been hard hit. The *Financial Times* (FT) on March 2 reported that one in six Chinese textile companies lost money last year, even though export prices increased 8 percent. According to the China National Textile and Apparel Council, growing wages and a weaker US dollar are squeezing the textile industry's profit margins.

The textile sector's average profit margin is 3.9 percent, but the bottom two-thirds of companies are struggling on an average margin of just 0.74 percent. While textile exports grew 19 percent last year to $US175.6 billion, national textile council chairman Du Yuzhou told the FT the industry was "relentless at weeding out the weak", with large corporations absorbing smaller bankrupt firms. Amid a wave of industrial restructuring, many corporations are shifting production to inland provinces or countries such as Vietnam, Indonesia and India, seeking cheaper labour.

The Asia Footwear Association estimates that about 15 percent of shoe makers in Dongguan—a major export hub in Guangdong's Pearl River Delta—have shut down or relocated in the past year. During that time, more than 1,000 mainly small and medium footwear factories have closed throughout the province—out of a total of 7,000-8,000. The Federation of Hong Kong Industries predicts that 10 percent of the 60,000-70,000 Hong Kong-owned factories in the delta will close this year. Many factories chose to shut before January 1—when limited new labour laws take effect, requiring employers to sign long-term contracts with workers, pay social security insurance premiums and provide higher compensation for layoffs.

A Hong Kong shoe factory owner, Leung Ka-yiu, who was planning to move his operations to Vietnam told *Asia Times* that since 2006 the Chinese government had been implementing polices that were unfavourable to the export processing. The measures included heavier taxes for foreign investors and reduced tax rebates for exports. "The labour law can be said to be the last push for me to leave," he said. "If the law is strictly followed, my factory's labour cost will increase by 20 percent, which many shoe factories like mine cannot afford, given our profit margin of about 8 percent." He laid off two-thirds of his workers in December.

Zhu Yongxin, a shoe factory owner in Foshan, Guangdong province, complained that the cost of steel for buttons had trebled from 20,000 yuan a tonne in 2004 to more than 60,000 yuan. Oil for sewing machines cost 75 yuan a barrel—up from 60 yuan a year ago. The cost of unskilled labour had risen to around 1,200 yuan ($US168) a month from 800 yuan two years ago. Skilled workers must now be paid 1,500-2,000 yuan. Zhu said he planned to move the factory to inland Hunan province.

Many migrant workers lost their jobs when they returned to work after the Chinese New Year. Lu Yongyuan, from Guizhou province found that his employer, the Taiwanese-owned Dongguan Hongsheng Mould Factory, had closed. Lu told the FT on February 25: "The government will auction the assets. Costs were just too high [to keep the business going]." A notice posted on the factory gate told its 300 workers to contact local village authorities to collect one month's wage, although the new labour laws require 10 months' redundancy pay.

Another factor is the rising yuan. Since the Chinese government delinked the currency from the US dollar in July 2005, it has risen by 16 percent against the dollar, placing enormous pressure on some exporters. Major Western retailers like Wal-Mart have refused to make any significant concessions on procurement prices from China. John Cheh, chief executive of Hong Kong-based Esquel, which makes more than 60 million shirts a year for major brands such as Nike and Gap, told the FT on March 2: "It's very difficult to raise prices. We show [clients] the numbers and say: 'Hey, we are losing money on your orders'."

Xu Jiangchang, general manager of a Ningbo-based garment exporter that employs 4,000 workers, told Reuters: "Each percentage point rise in yuan [against the dollar] means a half percentage point loss in our foreign exchange earnings". Zhou Dewen, head of the Wenzhou Small and Medium-Size Enterprise Development Promotion Association, pointed out that Wenzhou, which is famous for its small to medium factories, saw half the companies that started in 2007 suspend operations before the end of the year. "The average profitability of Wenzhou enterprises stands at only 3 to 5 percent of assets. A 3-percent yuan rise will wipe out profits in many firms here, in particular textile and shoe companies with low profitability," Zhou said.

The Chinese government has said these factory closures are part of President Hu Jintao's philosophy of "Scientific Development" for promoting technologically-intensive industries and moving up in the value chain. Tougher labour and environmental regulations are said to be efforts to build a "harmonious society". Chinese officials have commented that large corporations should wipe out small firms with low added value and backward technology. Beijing is also encouraging factories to move to inland provinces, supposedly helping to narrow the vast economic gap between rural and coastal regions.

The Chinese government, however, has no effective control over many factors behind the growing pressure on the manufacturing industry. Consumer demand in the US is slowing, with the subprime crisis and rising prices forcing many workers to cut back their spending. According to the Ministry of Commerce, Chinese exports to the US increased 20.4 percent in the first quarter of 2007, but the growth rate dropped to 15.6 percent and 12.4 percent in the following two quarters.

Nevertheless, China's rising production costs will be translated into higher consumer prices in the US and globally. Economic analysts have pointed out that China is likely to retain its position as the world's largest low-cost manufacturing platform because its huge workforce and extensive infrastructure still enable it to provide competitive advantages over other countries. Vietnam's share of the US apparel market jumped from 2.8 percent in 2005 to 6 percent this year, but China's share rose from 25 percent to 40 percent in the same period.

Wal-Mart vice chairman Michael Duke told the media on February 25 that his firm directly sourced $9 billion worth of goods from China in 2007. "China will continue to be a major portion of direct purchases by Wal-Mart for a long time," he said, adding that although some imports from China may be decreasing, others were increasing. The largest categories of Chinese exports are now machinery and electronics, such as auto parts, computers and electrical home appliances, rather than shoes, textiles and toys.

Rising inflation in China was signalled last year by serious pork shortages. It is now clear that inflation is a far bigger world problem. There has been a wave of financial speculation in global commodities markets, from basic metals to grains. Major energy and mining corporations are demanding huge prices increases from manufacturers. In February, Asian steelmakers were forced to accept a 65 percent increase in iron ore prices, which will be passed onto other industries.

Under these conditions, Chinese workers are demanding higher wages. In an interview with *Newsweek* on February 14, Auret Van Heerden, head of the Washington-based Fair Labor Association, offered his impressions from a recent visit to China. He commented on the new labour law: "At the factory level people are talking about it everywhere. One of the things about the law is it doesn't rely on outside labour enforcement... There have already been strikes about it; there have been employers who have been panicked by the commitment the law would require, so they've tried to lay off or outsource workers. The workers struck, saying, 'No, we're not going to accept that.' There have been a couple of high profile cases of strikes against dismissal involving Hong Kong-listed companies. Take the richest woman in China [Zhang Yin, CEO of Nine Dragon Papers], who owns a huge paper company. She tried to outsource guards and security cleaning services, and didn't want to give contracts. The workers struck. It's been an emblematic case: if one of the richest and most powerful businesswomen in China couldn't sidestep the law, it's a good indication of the signal the government wants to send."

As in the past, Beijing will not hesitate to use police-state methods to suppress unrest among workers. The real motive behind this legislation is fear of social instability. The intense exploitation of workers in sweatshops, coal mines and construction sites has created a climate for social explosions, worrying employers around the globe. Willie Fung, chairman of brassiere maker Top Form, told the *Australian* the biggest worry was not a cyclical US recession, but labour costs, which "once jacked up, cannot go down".

While sections of manufacturers are leaving China for countries such as Vietnam, they face similar problems. A wave of unrest among Vietnamese workers demanding higher pay has shaken foreign investors, amid escalating inflation. The annualised rate was more than 15 percent in February. On February 28, 1,500 workers went on strike at a South Korean garment factory in Long An province, demanding $10 more a month. On March 5, 10,000 workers at Tae Kwang Vina, a South Korean shoe contractor for Nike in Dong Nai province, struck for higher wages—although they were already paid 20 percent more than the minimum wage.

The Vietnamese official statistics record that 387 strikes occurred last year—with almost 300 in foreign-owned companies. Hanoi was forced to promise a 12 percent minimum wage increase this year. At the same time, the Vietnamese Stalinist regime's response to inflation—increasing interest rates and tightening money supply—has led to a severe shortage of the Vietnamese currency, the dong. The global scale of inflation and the crisis in manufacturing industry demonstrates the need for workers in China, Vietnam, Asia and beyond to develop an international movement against the global capitalist system.